



ECON 101

Six Concepts
to Mull over
and Memorize

A few arrows in the economist's quiver have proven to be powerful weapons in private and public decision-making, whether contemplating the purchase of a good, providing one's labor in the marketplace, getting married, or imposing taxes and regulations:

1. The familiar dictum – “There’s no such thing as a free lunch.” – acknowledges that for each of us, because wants exceed available resources, at least some goods, including information, are scarce. Thus we have to choose, and economics is the study of how people and societies make choices. And those choices entail costs – opportunity cost; that is, one’s best foregone alternative.

BY ALLEN R. SANDERSON

For most college students and MBA candidates, the largest cost of education is not tuition but not earning income for four (or two) years. Why are most marathons held on Sunday mornings? That’s the lowest opportunity cost time for a city – fewer traffic disruptions – and for the runners. Why the inverse relationship between a country’s birth rate and its stage of economic development? As the value of women’s time increases, families will have fewer children.

2. For individuals and societies, these choices involve tradeoffs. I could work more and have more money but less leisure time. Chicago banks could reduce robberies by hiring a guard, but that costs \$50,000 a year; it’s arguably cheaper for them to get

held up once in a while. A recent study concluded that the safest seat on an airplane is in the middle seat of the back rows. If this is the case, why are those the least desirable ones? Because we’re not willing to trade off the certainty of being uncomfortable for the next three hours for the possibility of a tad more safety. The same holds in an automobile: we voluntarily sit in the front passenger’s seat to be sociable, but that is the least safe seat in that vehicle.

More money for defense means less for health care; more spending on environmental amenities means less money for the poor. A big societal tradeoff is efficiency – not wasting resources – v. equity – the fair distribution of those resources. The price we are likely to pay for reducing inequality is less total output. Why?

3. People generally respond to incentives. Government redistributions of income reduce the incentives – for both rich and poor – to work. Why did the 2009 Christmas “underwear bomber” pick the Amsterdam to Detroit flight? Apparently it was the cheapest ticket for al-Qaeda. Why do Americans drive larger cars than Europeans? Check the price of gas on both continents. Alter the expected rewards associated with pursuing more education or committing a crime and: bingo!

Whether people choose rationally and are purposeful, predictable, and consistent in their decisions is grist for another day.

4. We make few all-or-nothing decisions in life but rather at the margin, choosing between a little bit more or a little bit less – one more cookie but not the whole bag; five miles over the speed limit,

not 25; one less hour of television, not going “cold turkey.” The difference between a .300 hitter (and thus a millionaire) and a .260 hitter (at the brink of ending one’s career) in baseball is only 1 hit a week. UPS and FedEx select routes to avoid time-consuming left turns and try hard to shave one mile off their drivers’ daily routes. Those incremental savings are worth millions of dollars annually to those firms.

5 . Beware of secondary or indirect effects. Raising the minimum wage sounds like a good idea – until you lose your job to a machine or a higher-skilled worker. Penalizing airlines for tarmac delays has resulted in more flight cancellations and longer delays for stranded passengers. Ski helmets haven’t reduced brain injuries much; you increase my safety and I ski tougher terrain and take more risks. We increase both fuel efficiency and automobile deaths when opting for smaller cars. And a recent Time headline: “The Dark Side of Cheap Gas – More Road Deaths.”

6. Trade – between people or nations – creates value. We specialize in what we’re relatively better at and trade for things for which we’d be a high opportunity-cost producer. Or as Adam Smith expressed it in 1776 and it remains applicable today: “It is the maxim of every prudent master of a family, never to attempt to make at home what it will cost him more to make than to buy. . . . If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage.” □